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SUBJECT: The Impact Of Low Oil Prices On The Indo-Soviet Relationship [redacted] 25X1

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Central Intelligence Agency

Washington, D.C. 20505

DIRECTORATE OF INTELLIGENCE

21 May 1986

The Impact Of Low Oil Prices On The Indo-Soviet Relationship [redacted] 25X1

SUMMARY

Moscow is in the process of significantly reducing its oil prices to New Delhi, probably to near world market levels. Much lower oil prices would enable India to more easily meet its payments to the Soviet Union for arms, which will grow rapidly over the next 10 years. To offset lower prices, we believe Moscow will put pressure on New Delhi to buy more Soviet goods, including military items. An Indian refusal to substantially step up imports from the USSR could cause serious strains in the relationship. The political importance of the relationship to both sides, however, probably will induce them to work out a payments settlement. [redacted] 25X1

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This memorandum was prepared by [redacted] the Office of Near Eastern and South Asian Analysis, with contributions from [redacted] Office of Pakistan-Bangladesh Branch, and [redacted] 25X1 Office of Soviet Analysis in response to a request by the 25X1 Department of State. Information as of 16 May 1986 was used in its preparation. Comments and queries may be addressed to the Chief, South Asia Division, NESA, [redacted] 25X1

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The Economic-Military Relationship

The Soviet Union is India's largest commercial trading partner after the United States with total two-way trade of about $3.7 billion in 1985. The trading relationship consists largely of an exchange of Soviet petroleum for Indian agricultural products and consumer goods. In addition we estimate India paid the Soviets about $600 million last year for military imports. [redacted] 25X1

India's economic relations with the Soviet Union are governed by an agreement to balance all bilateral payments for imports, exports, and debt service. All transactions, whether commercial or military, are handled in Indian rupees through the Indian banking system; neither party has any need to pay nor opportunity to earn hard currency. [redacted] 25X1

Over the last three years, the bilateral trade balance has deteriorated from New Delhi's perspective. The Indians have met or exceeded the level of imports specified in the trade protocol while Moscow has fallen below its quota in accepting Indian exports. A continuation of this trend would make it difficult for India to meet its payments for military imports. We believe the Indo-Soviet trade relationship calls for an Indian surplus in commercial trade to be used to cover New Delhi's debt for imports of Soviet military equipment. [redacted] 25X1

Paying for the expansion and modernization of the Indian armed forces seems likely to become a more serious concern for India over the next decade. Indian officials were worried in mid-1985 about the growing burden of payments for arms supplied by the USSR. India has purchased over $7 billion in Soviet arms since 1980, and its annual payments to Moscow for arms already purchased will probably increase from $600 million in 1985 to as much as $1.8 billion by 1994. [redacted] 25X1

The Importance of Oil

Crude oil and petroleum products have accounted for about 70 percent of Moscow's commercial exports to India over the last three years. Our analysis of Indian and Soviet trade statistics indicates petroleum exports have averaged about 115,000 b/d, roughly 40 percent of India's net oil imports. A large share of the products have been of Soviet origin, but most of the crude oil is delivered primarily from the Middle East on Soviet account. [redacted] 25X1

In December, India and the Soviet Union signed a trade and payments agreement that extends the trade relationship through 1990, and in addition set a two-way trade target for this year at

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an estimated $4.5 billion. The US Embassy in New Delhi indicates the oil import target for 1986 is 120,000 b/d--70,000 b/d of crude oil and 50,000 b/d of products. We have no information on what, if any, provisions this agreement made for Soviet oil export prices; at the time of the agreement world oil prices were about double today's prices. The Soviets have charged the Indians an average of $32 per barrel for deliveries of crude oil and products over the last three years--roughly the world market price. [redacted] 25X1

Status of the Oil Relationship

The Soviets and Indians probably are still negotiating this year's overall contract for crude oil and products, but we believe a settlement is near. The Soviets probably will lower the price of crude oil to roughly $12-$16 per barrel. [redacted] 25X1 25X1

Moscow has already lowered the price of crude oil for Finland, its other major non-communist soft currency trading partner to $15 per barrel from $27 per barrel last year. [redacted] 25X1

Soviet product prices likely will average about $20 per barrel. In late April, India had arranged for the purchase of up to 50,000 b/d of petroleum products from the Soviet Union. No formal agreement has been signed, but some products have already been delivered. [redacted] 25X1

The Indian press reported in late March that New Delhi had decided to buy crude oil on the spot market instead of renewing contract purchases from the the Soviet Union, but we do not believe New Delhi was serious. Rather, it probably used the threat to get a better price. The Indians do not want to use more of their hard currency to buy oil in the West; Soviet oil, even if more expensive, is paid for with Indian goods. Some Indian press analysis indicates only 20-25 percent of these goods could be sold readily in Western markets. [redacted] 25X1

Implications for the Relationship

A lower oil price could lead to strains in the Indo-Soviet relationship. New Delhi would try to maximize its gains while Moscow would try to minimize its losses. [redacted] 25X1

Cheaper Soviet oil would change the bilateral trade balance dramatically in India's favor and reduce significantly the burden of arms payments through the remainder of the decade. If, for example India can buy oil at $15-$20 per barrel, it would save $500-$700 million annually at the 1985 level of deliveries. [redacted] 25X1
[redacted] 25X1

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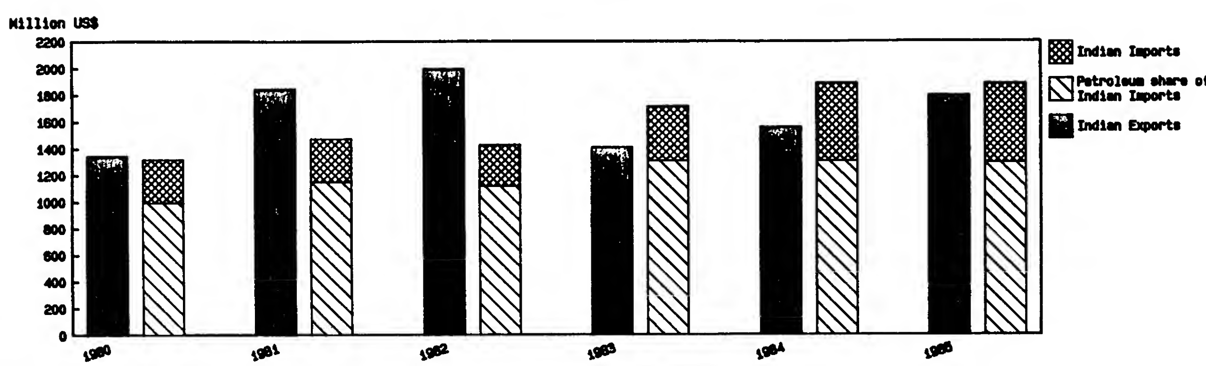
Under these circumstances, the Soviets, probably would put greater pressure on India to increase purchases of Soviet manufactured goods and military items, or threaten to reduce imports of Indian goods. India, however, would continue to resist both major increases in imports of Soviet manufactured goods--because of their poor quality--and a cut in Soviet imports of Indian goods--which could lead to more Indian unemployment and factory closings. 25X1

We also believe it unlikely that New Delhi will purchase large amounts of additional Soviet military hardware, although, it might accept offers of expensive high technology items, such as nuclear attack submarines and AWACS aircraft. Indian defense modernization plans call for reducing dependence on Moscow in favor of increased imports of Western arms and defense production technology. By 1990 the Indians will have completed a major force expansion program and are not likely to be in the market for large quantities of new weapons. New Delhi, however, may offer to accelerate the payment schedule for military equipment already purchased. 25X1

Both countries have sufficient political, economic, and military interests at stake to work out a payments balance. For Moscow the political benefits of retaining India as a friend will probably outweight the economic costs of making concessions on the trade relationship. New Delhi also has too much at stake in the defense relationship to reduce significantly relations with the USSR. Nonetheless, we believe lower oil prices will reduce India's economic dependence in Moscow and limit the importance of Indo-Soviet economic ties. 25X1

INDO/SOVIET COMMERCIAL TRADE (a)
1980-1985



a. May include some unspecified military items.

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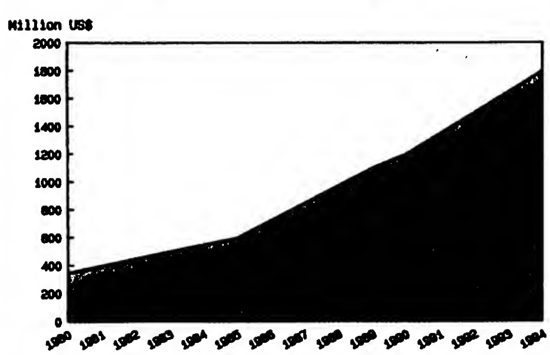
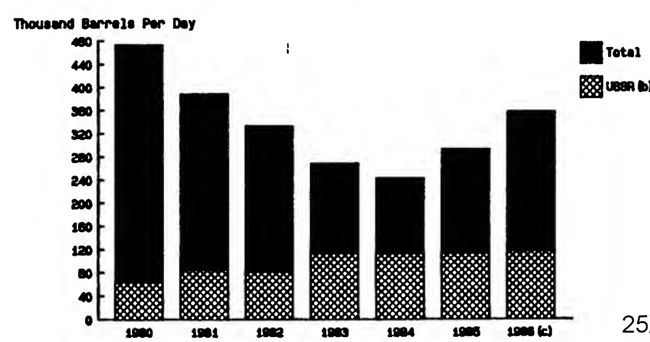
INDIA'S ESTIMATED ANNUAL PAYMENTS
FOR MILITARY IMPORTS FROM THE USSR



SOVIET SHARE OF INDIAN NET OIL IMPORTS (a)



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a. Includes crude and products
b. Includes third party crude delivered on Soviet account
c. Estimate of Planned Imports

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